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MICHAEL RODAK, JR.,

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1973

No. 72-1668

JAMES T. SHIOSAKI, Petitioner

COMMISSIONER OF INTERNAL REVENUE, Respondent

PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

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PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

The petitioner, James T. Shiosaki, respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Ninth Circuit entered in this proceeding on March 14, 1973.

OPINION BELOW

The opinion of the United States Court of Appeals for the Ninth Circuit has not yet been reported and it is in the appendix.

JURISDICTION

The judgment of the United States Court of Appeals for the Ninth Circuit was entered on March 14, 1973 and this petition for a writ of certiorari was filed within 90 days of that date. This Court's jurisdiction is invoked under 28 U.S.C. sec 1254 (1).

QUESTIONS PRESENTED

Whether disallowance of ordinary and necessary expense deductions incurred in gambling income production claimed under I.R.C. 1954 sec. 212 (1) violates the due process of law clause of the Fifth Amendment to the Constitution of the United States.

STATUTES INVOLVED

Sections 61 (a), 63 (a), 162 (a) [23(a) (1) (1939)], 165 (d), 211, 212 (1) [23(a)(2)(1939)] and 262 I.R.C. 1954 are set forth in Appendix B hereto.

Fifth Amendment to the Constitution of the United States (in part) - No person shall...be deprived of life, liberty, or property, without due process of law;....

STATEMENT OF THE CASE

This case involves the disallowance by the respondent of ordinary and necessary expense deductions incurred in gambling for the year 1967 claimed by the petitioner under I.R.C. 1954 sec.212(1). The decision of the Tax Court in favor of the respondent was entered on February 19, 1971. The petitioner appealed on the ground that gambling as practiced by the petitioner is for the production of income. The Court of Appeals for the Ninth Circuit, whose jurisdiction was invoked under I.R.C. 1954 sec.7482, affirmed the decision without oral argument which resulted in the assessment of a tax deficiency of $393.76 for the year 1967 with interest in the additional amount of $94.70.

The facts material to this case as found in the transcript of the trial in the Tax Court follows:

The petitioner first went to Las Vegas with friends in 1957 for recreation and entertainment, expending $60 for gambling. However, at one point during that weekend, $240 was won before losing it and the original $60 while gambling at craps (Tr.-20).

He became interested in craps for income

production and began a continuing study of it (Tr.-20). He concluded that in order to overcome the slight casino advantage of 1%, bigger bets must be made when winning and smaller bets when losing (Tr.-29). He soon started going to Las Vegas alone for the purpose of producing an income (Tr.-33). He started investing in the stock market in 1957 before becoming involved in gambling. His stock investments continued in 1958 and 1959 until in 1959 they were liquidated to concentrate on gambling (Tr.-17). In the last five weekends of 1959 he won $12,000 while losing about $6,000 up to that time for a net winning from gambling at craps in Las Vegas of $6,000 which was reported in his tax return for 1959 (Tr.-17,32). However, since 1959 on through 1969, petitioner has not had any year with net winnings while expending between $5,000 to $10,000 during about an average of seven weekend and vacation trips per year financed through his job as an engineer at a salary of about an average of $14,000 per year (Tr.-26,27,32).

In 1967, the year in controversy, petitioner won $1,300, claimed $1,300 of gambling losses allowed under I.R.C. 1954 sec. 165(d) although the actual loss was about $10,000, and claimed $1,230.51 of ordinary and necessary expenses under I.R.C. 1954 sec. 212(1) (Tr.-10-16). The deduction in controversy is the $1,230.51 which consists of:

Transportation to and from airport	$ 72.00
Air tickets	413.70
Air insurance	22.00
Hotels	372.31
Meals	167.00
Cabs	129.00
Auto Storage	54.50
TOTAL	$1,230.51

(from written stipulation of facts) (Tr.-4)

Respondent argued that (Tr.-6):

(1) "...the expenses in issue in this case fall more within the personal expenditure

area of [I.R.C. 1954] section 262 than within section 212...

(2) "...expenses should be considered part of petitioner's losses, and, thus, not deductible in a year such as the one we have where losses exceeded the gains.

(3) "...some of the expenditures in issue did not bear a proximate relationship to the gambling income, or activity, and could not qualify for deduction in any event."

The Tax Court decision for the respondent was based on argument (1) above contending that "... petitioner has failed to show that in incurring expenses for trips to Las Vegas in 1967 to engage in gambling he was motivated by a bona fide profit seeking purpose. We have drawn this conclusion... from a conviction that petitioner himself, were he not so inextricably caught up in the gambling game, could not expect, by reason of these sustained losses, to turn a profit." (T.C. Memo. 1971-24).

The Court of Appeals for the Ninth Circuit affirmed the decision based on arguments (1) and (2) above.

REASONS FOR GRANTING THE WRIT

The decision below denies the due process of law by conflicting in principle with other courts as to the proper interpretation of I.R.C. 1954 Sec. 212 (1) and this issue is of continuing importance because it affects the petitioner for subsequent years up to the present time and it may potentially affect thousands of others.

The Tax Court erred in requiring a profit in the determination of gambling as an income producing activity. I.R.C. 1954 sec. 212 (1) specifically allows deductions of ordinary and necessary expenses for the collection or production of income to compute taxable income as provided in I.R.C. 1954 sec. 211. Taxable income is defined in sec. 63 (a) as gross income minus allowable deductions. Gross income is defined in sec. 61 (a) as all income from whatever source derived.

Gambling at craps is the activity in which the petitioner had engaged in 1967 for income production. In this activity there is an average of one decision per minute with an average bet of $20 made by petitioner resulting in $20 per minute in bets. Over a weekend an average of 16 hours is spent gambling. This results in an average of:

16 hrs. X 60 min./hr. X $20/min.= $19,200 in bets. Of this figure according to the odds, 50.5% are losses and 49.5% are wins. This results in a cash income flow of $9,500 and a cash outflow of $9,700. This is possible with a playing capital of $1,000 which is the amount the petitioner usually uses. The slight advantage for the casino may be overcome by betting bigger when winning and smaller when losing. The cash flow is present for the skilled gambler to make a profit - note the $240 profit at one point made with $60 capital in 1957 and the income of $12,000 in 5 weekends for a net profit of $6,000 made in 1959 by the petitioner. There is no question of a cash income in gambling although there may not be a net profit. I.R.C. 1954 sec. 212 (1) requires production of income as opposed to taxable income (profit) in order to qualify for ordinary and necessary expense deductions which qualifies gambling.

Comparing gambling to other income producing activities allowed ordinary and necessary expense deductions under section 212 (1954) or the equivalent section 23 (a)(2)(1939), we find:

1. In Crymes v. Commissioner, T.C. Memo.1972-3:

> "...we believe that the petitioner had a profit motive. Perhaps someone else may have used a different approach or may have written the booklets differently. But here the proper test is not the reasonableness of the taxpayer's belief that a profit will be realized, but whether the enterprise is entered into and carried on in good faith and for the purpose of making a profit, or in the belief that a profit can be realized thereon, and that it is not conducted merely

for pleasure, exhibition, or social diversion.

"We believe the petitioner published the books with a dual purpose. She wished to make known her ideas and at the same time realize a profit. There is no question she expended a great amount of time in producing the booklets and that she paid substantial amounts to have them printed. Although unsuccessful, she was endeavoring to interest people in her ideas through the booklets and intended to sell them at a profit if anyone evidenced an interest. The fact that she was not able to do so in no way negates the fact that expenses were incurred and we hold that they are deductible by the petitioner in 1967."

2. In Hartford v. United States of America, 265 F. Supp. 86 (1967):

"The Government argues that the terms of the lease from Hartford to The Carlin Club, Inc., made it virtually impossible for Hartford to receive any income from the transaction. While practical factors restricted the maximum possible rental under the lease to $10,000, the necessary expenses connected with the leased premises, it is contended, would always exceed $10,000. Therefore, Hartford could never realize 'income' if income is defined as an excess of receipts over expenses.

"I cannot agree that in Section 212 Congress intended such a restricted meaning of 'income'. Rather the word should be taken to mean an inflow of money or gross receipts. The Code is replete with instances in which the expression 'taxable income' is used when it is desired to refer only to receipts remaining after deduction of expenses. See, e.g., §§ 63, 161...

The circumstances also dispose of the suggestion that it is inherently improbable that one would hold property for income over

a period of years while receipts failed to match expenses...

"George Hartford's illness coupled with his wife's lack of business and promotional skills, is a sufficient explanation of the failure to increase the rental during these years.

"I conclude that the disputed expenses were ordinary and necessary expenses paid or incurred during the taxable years 1955, 1956, 1957, 1960, 1961, and 1962, for the management, conservation, and maintenance of property held for the production of income, within the meaning of Section 212, and that the deductions for them should have been allowed."

3. In Lord v. Commissioner, Op. Dkt. 27,532 (1951):

"The respondent contends that the rental payments made by petitioner after March 20, 1942, are not deductible under the provisions of Section 23 (a) (2). He contends that there must be an actual production of income, not merely an effort to produce income, before the payments can be treated as expenditures made 'for the production*** of income', and that rentals paid on a lease for a vacated personal residence cannot qualify as expenses paid 'for the management, conservation, or maintenance of property held for the production of income'...

"...Beginning in January, 1942, and continuing through the years 1942 and 1943, he made diligent efforts through real estate firms to rent the property without success...

"...The mere fact that petitioner was attempting to minimize a possible loss in seeking to obtain an income-producing sublease does not render Section 23 (a) (2) inapplicable.....

"...rental payments made while a diligent effort is being made to secure a sublessee qualify as ordinary and necessary expenses paid 'for the produciton of income' within the meaning of Section 23 (a) (2)...."

Although the cases cited above were not in courts where judgment is final, the two cases tried in the Tax Court give them finality due to the special expertise of this court on matters relating to questions on taxation. This position is taken in the concurring opinion of the Supreme Court in Bingham's Trust v. Commissioner of Internal Revenue, 325 U.S. 365.

4. In Bingham's Trust v. Commissioner of Internal Revenue, 325 U.S. 365:

"Section 23(a) (2) is comparable and in pari materia with § 23 (a) (1), authorizing the deduction of business or trade expenses. Such expenses need not relate directly to the production of income for the business. It is enough that the expense, if 'ordinary and necessary', is directly connected with or proximately results from the conduct of the business.....

"Since there is no requirement that business expenses be for the production of income, there is no reason for that requirement in the case of like expenses of managing a trust, so long as they are in connection with the management of property which is held for the production of income. Section 23(a) (2) thus treats the trust as an entity for producing income comparable to a business enterprise, and like § 23 (a) (1) permits deductions of management expenses of the trust, even though the particular expense was not an expense directly producing income. It follows that all of the items of expense here in question are deductible if, as the Tax Court has held, they are

expenses of management or conservation of the trust fund, whether their expenditure did or did not result in the production of income."

I.R.C. 1954 sec. 162(a) is equivalent to I.R.C. 1939 sec. 23 (a) (1).

5. In Commissioner of Internal Revenue v. Goldberger's Estate, 213 F2d 78, the above case, Bingham's Trust was cited to apply to an estate just as well as a trust.

6. In Mercer v. Commissioner, 376 F2d 708:

"The government points to the fact that the petitioner held a full-time job and spent only four months at Berle's ranch during the two years in question. Yet such a circumstance hardly supports a conclusion that the petitioner was not engaged in the cattle business. It is reasonable to conclude that work as a laborer was necessary to raise the funds required to support his cattle operation. In any event, it is not a necessary prerequisite that one devote himself completely to an enterprise to qualify it as a trade or business. ...

"It seems clear from a reading of the opinion of the Tax Court that its decision was in essence a conclusion that the taxpayer's venture was not aimed at profit because a reasonable man would not expect a profit from such a venture, and that while he might in future get into such a business, he had not yet done so in the years in question. We are aware that other circuits have insisted that the taxpayer's expectation of profit be both reasonable and in good faith....

".....Unquestionably, however, in this circuit the rule is that a taxpayer's venture is a trade or business if he has a good faith expectation of profit from that venture, irrespective of whether or not others might view that expectation as reasonable.....

"Here the taxpayer entered into a venture with a good faith expectation of profit. Whether that expectation was foolhardy or shrewd is of no moment. The taxpayer expended his effort and capital to the limit of his available time and resources. There can be no conclusion other than that the taxpayer's venture, though small in results, was a trade or business within the meaning of sections 162 and 165."

These cases clearly show that the petitioner's case closely parallels in principle those conditions requisite to allowance of ordinary and necessary expense deductions. The fact that he was disallowed these deductions denies him due process of the law as provided by the Fifth Amendment to the Constitution.

This case is of continuing importance since it affects the petitioner in all subsequent years from 1967 to the present and it may potentially affect thousands of other gamblers who now find themselves outcasts from due process of the law.

CONCLUSION

For these reasons a writ of certiorari should issue to review the judgment and opinion of the Court of Appeals of the Ninth Circuit.

Respectfully submitted,

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APPENDIX A

OPINION AND JUDGMENT OF THE COURT OF APPEALS

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

James T. Shiosaki, Appellant, vs. Commissioner of Internal Revenue, Appellee	No. 71-1909

(March 14, 1973)

On Appeal from the Decision of the
United States Tax Court

Before: CHAMBERS, HAMBLEY and MERRILL, Circuit Judges

CHAMBERS, Circuit Judge:

Shiosaki is an electrical engineer in Southern California. He has had and still has an urge to shoot craps at the Sands Hotel and other places in Las Vegas, Nevada. He seems to have had the same employer of his engineering talents for a good many years. Obviously he knows more of electricity than he knows of craps. He had large winnings in 1959, so he started to make a study of craps so that he might be more proficient and win more. But his studies have produced no apparent good results.

Since 1959 he has lost usually each year at the crap table. Doggedly he pursues this sideline, only eating up his savings which are a fair portion of his earnings as an engineer. He has become no burden to his friends, family or banker.

In 1967, he reported winnings from some 12 trips to Las Vegas in the amount of $1300. Then he deducted $1300 as losses at the crap table, although his losses were substantially higher, in fact $6,700 higher. The law is clear that $1300 would be all he could deduct from losses at the table, 26 U.S.C. § 165(d). But Shiosaki spent $1230 on travel and hotel expense, which for 1967 he took as a deduction. The commissioner and the tax court have disallowed this resulting in a tax deficiency of about $400.

Shiosaki is obviously very serious and sincere. His testimony was uncontradicted. It reads as that of a gentleman. But the tax court has held that the $1230 could not be deducted as an ordinary and necessary expense paid for the production of income. It said it does not qualify under § 212 (1) of the Internal Revenue Code of 1954.

There is no aspect of illegal gambling whatsoever in this case. (Even in legal gambling the normal rule is that losses are not deductible to a greater extent than profits.) Were the amount of $1230 to be found under § 212 (1), the government would still disallow it because it would call it a gambling loss against the winnings, in this case already used up by losses at the table. We need not reach the latter question because we affirm the holding that the expense was not a "business" expense. The tax court listened to Shiosaki testify at length. It obviously concluded that the true motive of the trips was not predominantly to make a profit, despite Shiosaki's positive attestation that it was. We are in an area where we cannot revise the fact finder's finding.

Decision affirmed.

APPENDIX B

STATUTES INVOLVED

The pertinent portions of the Statutes involved are:

Internal Revenue Code of 1954.

Sec. 61. Gross Income Defined

(a) General Definition - Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items: ...

Sec. 63. Taxable Income Defined

(a) General Rule - Except as provided in subsection (b), for the purposes of this subtitle the term "Taxable Income" means gross income, minus the deductions allowed by this chapter, other than the standard deduction allowed by part IV (sec. 141 and following).

(b) Individuals electing Standard Deduction...

Sec. 162. Trade or Business Expenses.

(a) In General - There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including:

(1) a reasonable allowance for salaries...

(2) traveling expenses...

(3) rentals or other payments required...

(Sec. 23 (a) (1) 1939)

Sec. 165. Losses.

....

(d) Wagering Losses. - Losses from wagering transactions shall be allowed only to the extent of the gains from such transactions.

Sec. 211. Allowance of Deductions.

In computing taxable income under section 63 (a), there shall be allowed as deductions the

items specified in this part, subject to the exceptions provided in part IX (section 261 and following, relating to items not deductible).

Sec. 212. Expenses for Production of Income.

In case of an individual there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year -

(1) for the collection or production of income;

(Sec. 23 (a) (2) 1939)

Sec. 262. Personal, Living and Family Expenses.

Except as otherwise expressly provided in this chapter, no deduction shall be allowed for personal, living, or family expenses.

In the Supreme Court of the United States

OCTOBER TERM, 1973

No. 72-1668

JAMES T. SHIOSAKI, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum findings of fact and opinion of the Tax Court (I-R. 13-23)[1] are unofficially reported at 30 T.C.M. 110. The opinion of the court of appeals (Pet. App. A, 12-13) is reported at 475 F. 2d 770.

JURISDICTION

The judgment of the court of appeals was entered on March 14, 1973. The petition for a writ of certiorari was filed on June 11, 1973. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

[1] "I-R." and "II-R." references are to the record filed in the court of appeals.

QUESTION PRESENTED

Whether the court of appeals correctly affirmed, as not clearly erroneous, the Tax Court's finding that petitioner's gambling activities were undertaken primarily for recreation and not for profit.

STATUTES INVOLVED

The pertinent provisions of 26 U.S.C. 162, 165, 212, and 262 are set forth at Pet. App. B, 14-15.

STATEMENT

Petitioner is an electrical engineer and has been regularly employed in that capacity since 1957. Since 1960, his annual salary has averaged approximately $15,000.

Petitioner went to Las Vegas, Nevada in 1957 for recreation, and while there he was introduced to the gambling game of craps (I-R. 14). Commencing in 1959, petitioner went to Las Vegas several times each year and engaged in gambling—principally at the craps table. In 1959, petitioner was quite successful, aggregating net winnings of $6,426. His fortunes declined, however, and during each of the years 1960 through 1969 he suffered net losses; petitioner's total losses for those years approximated $50,000 (I-R.14-15).

During 1967, the year in controversy, petitioner made 12 trips to Las Vegas for the purpose of gambling. His gross winnings were $1,300 and his gross losses were about $8,000. Petitioner also incurred expenses totalling $1,230.51 for transportation, lodging, meals, etc., in connection with these trips (I-R.16).

On his federal income tax return for 1967, petitioner reported gambling winnings of $1,300 and gambling

losses of the same amount.[2] Petitioner also claimed a deduction of $1,230.51 as "expenses incurred in obtaining gambling income" (I-R. 17). In a notice of deficiency, the Commissioner disallowed this deduction on the ground that the expenses were not incurred for the purpose of producing income but rather were personal expenditures and thus nondeductible under Section 262 of the Internal Revenue Code of 1954. The Tax Court sustained the Commissioner's determination and the court of appeals affirmed the Tax Court's finding as not clearly erroneous.

ARGUMENT

1. Section 212(1) of the Internal Revenue Code of 1954, 26 U.S.C. 212(1), allows individuals to deduct ordinary and necessary expenses incurred for the production of income. This provision permits the deduction of certain profit-motivated expenses even when the income-producing activity does not constitute the taxpayer's trade or business. However, Section 212(1) is limited by Section 262 of the Code, which prohibits the deduction of personal expenses, such as normal recreational and entertainment expenditures. As this Court emphasized in *Lykes* v. *United States,* 343 U.S. 118, 122, the addition of the statutory predecessor of Section 212 did not "authorize widespread deductibility of personal, living or family expenditures."

An expense is incurred "for the production or collection of income," within the meaning of Section 212(1), only when the taxpayer can demonstrate that the alleged income-producing activity is being engaged in for the purpose of making a profit. *Carkhuff* v. *Commissioner,*

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[2] Section 165(d) of the Internal Revenue Code of 1954 provides that losses from wagering transactions shall be allowed only to the extent of gains from such transactions.

425 F. 2d 1400 (C.A. 6); *Bessenyey* v. *Commissioner*, 379 F. 2d 252 (C.A. 2), certiorari denied, 389 U.S. 931. Whether an activity is profit-motivated is a factual question to be determined from all the circumstances of the cases; consideration is to be given, *inter alia*, to the history of gain or loss and to the principal occupation of the individual. See 26 C.F.R. 1.212-1(c).

Both prior and subsequent to the year in issue, petitioner consistently incurred net losses from his gambling (I-R. 15). He testified that he was aware that only a very small percentage of gamblers were successful at craps (II-R. 32-33) and that he had a tendency to use unsuccessful methods of betting (II-R. 34-35). Moreover, there was no connection between petitioner's gambling trips and his principal occupation; to the contrary, his trips served the purpose of relaxation and recreation (II-R. 33-34). In short, there was ample evidence here to support the Tax Court's finding that petitioner's gambling was not profit-motivated and this factual issue warrants no further review.

2. Petitioner relies (Pet. 5-10) upon several decisions in which deductions were allowed under Section 212(1) or a predecessor provision. But those cases all involved facts supporting the existence of a profit motive. By contrast, petitioner's gambling activities were primarily recreational. His expenses in traveling to Las Vegas should be treated no more favorably for tax purposes than the expenses of other taxpayers who travel for recreation.[3]

---

[3] Petitioner suggests (Pet. 2, 10) that the disallowance of his claimed deductions constitutes a denial of due process, presumably on the theory that he is being deprived of a legitimate business expense deduction merely because his business is gambling. But there is no factual basis for such an argument: petitioner gambles not for profit but for fun, and his related expenses are treated in the same manner as the non-business recreational expenses of other taxpayers.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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